



COUNTY OF LOS ANGELES

FIRE DEPARTMENT

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DARYL L. OSBY
FIRE CHIEF
FORESTER & FIRE WARDEN

February 22, 2013

TO: EACH SUPERVISOR
FROM: DARYL L. OSBY, FIRE CHIEF

FIRE DISTRICT - FINANCIAL PLAN UPDATE

In August 2012, the Fire District (District) updated the Financial Plan to explain the financial imbalance between revenue and expenditures, which at that time indicated a projected structural deficit of \$43.4 million. This was shared with your respective staff and discussed at the September 4, 2012, Board of Supervisors meeting. We are currently projecting an \$11.6 million structural deficit for Fiscal Year (FY) 2012-13. This improved financial outlook is attributed to overall efforts for containing costs, as well as \$3.9 million in additional prior-year revenue and \$19.79 million in additional revenue related to the Community Redevelopment Agency dissolution.

Please note that the following chart depicts our projections for the next four (4) fiscal years:

| Structural Deficit (\$ in Millions) | 2012-13 | 2013-14 | 2014-15 | 2015-16 | 2016-17 |
|--------------------------------------|----------------|----------------|---------------|---------------|---------------|
| Revenue (On-Going) | \$878.1 | \$878.7 | \$891.4 | \$912.6 | \$934.8 |
| Expenditures (On-Going) | <u>-889.7</u> | <u>-892.4</u> | <u>-899.3</u> | <u>-908.8</u> | <u>-925.3</u> |
| Projected Structural Deficit/Surplus | -\$11.6 | -\$13.7 | -\$7.9 | \$3.8 | \$9.5 |

In 2012, we procured the services of the Macias Consulting Group to review the projections used in our multi-year fiscal forecast. They concluded that our projection process uses reasonable methods, data, and adjustments. We have attached a copy of their report for your reference. While we are confident that the latest estimate continues to reasonably project our structural deficit, it should be noted that the projection does not include the following:

- Cost related to any potential COLA increases

SERVING THE UNINCORPORATED AREAS OF LOS ANGELES COUNTY AND THE CITIES OF:

| | | | | | | | |
|--------------|-----------|------------------|----------------------|-----------|----------------------|-----------------------|------------------|
| AGOURA HILLS | CALABASAS | DIAMOND BAR | HIDDEN HILLS | LA MIRADA | MALIBU | POMONA | SIGNAL HILL |
| ARTESIA | CARSON | DUARTE | HUNTINGTON PARK | LA PUENTE | MAYWOOD | RANCHO PALOS VERDES | SOUTH EL MONTE |
| AZUSA | CERRITOS | EL MONTE | INDUSTRY | LAKEWOOD | NORWALK | ROLLING HILLS | SOUTH GATE |
| BALDWIN PARK | CLAREMONT | GARDENA | INGLEWOOD | LANCASTER | PALMDALE | ROLLING HILLS ESTATES | TEMPLE CITY |
| BELL | COMMERCE | GLENDALE | IRVINDALE | LAWDALE | PALOS VERDES ESTATES | ROSEMEAD | WALNUT |
| BELL GARDENS | COVINA | HAWAIIAN GARDENS | LA CANADA FLINTRIDGE | LOMITA | PARAMOUNT | SAN DIMAS | WEST HOLLYWOOD |
| BELLFLOWER | CUDAHY | HAWTHORNE | LA HABRA | LYNWOOD | PICO RIVERA | SANTA CLARITA | WESTLAKE VILLAGE |
| BRADBURY | | | | | | | WHITTIER |

- Cost related to critical infrastructure needs

Currently, our critical infrastructure needs estimate is \$423.9 million and is detailed on page 8 of the Macias Report. For purposes of this memo, we have excluded the costs for the Klinger Replacement and the L.A. Headquarters Refurbishment/Stabilization projects, as these two projects would not be necessary if we move forward with the New Headquarters Construction project. We are currently working with the CEO to validate the critical infrastructure needs estimate.

We are projecting a \$158.1 million balance in our reserves at the end of FY 2012-13; however, this amount is insufficient to meet both our infrastructure needs and ensure we maintain an appropriate reserve for budget uncertainties.

| Reserves (\$ in Millions) | 2012-13 |
|---------------------------------|----------------|
| Projected Ending Fund Balance | \$46.2 |
| Designation Balance at Year-End | |
| Budget Uncertainties | 52.0 |
| Infrastructure Growth | 18.3 |
| Capital Projects | 41.6 |
| Total | \$158.1 |

Please note that in FY 2008-09, the District implemented a hiring freeze for non-emergency positions to reduce our structural deficit. While the District was exempt from the County's hiring freeze, our freeze reduced our budget by \$6 million per FY. However, we can no longer fully sustain this freeze as the effectiveness of our internal support operations (e.g., Payroll Services, Risk Management, Employee Relations, Procurement Services, Warehousing, Fleet Services, and Information Technology) has been impacted. Therefore, we plan to restore some of the critical positions.

The District has also initiated the following to reduce the structural deficits and ensure efficiencies:

- Microsoft Assessment – This assessment of business operations provided suggestions for improving efficiencies. We will incorporate some of the suggestions provided by Microsoft to our FY 2013-14 Final Changes budget.
- Carve-Out Program - On January 1, 2013, we implemented the Board-approved Labor-Management Workers' compensation, Dispute Resolution agreement. This program provides active employees claiming compensable injuries with an expedited procedure to resolve medical disputes and to facilitate their prompt return to work.
- Risk Management - Additional and more focused efforts toward risk management challenges for FY 2013-14.

- Potential Revenue Streams – Exploring programs (e.g., emergency medical services, emergency response to vehicle accidents, fire prevention and special tax) which, with Board approval, will generate additional revenue for the Department.

On September 4, 2012, your Board adopted a motion directing the Chief Executive Office (CEO) and the Auditor-Controller (A-C) to provide a report on our financial status. While the CEO and the A-C will provide their report in March 2013, we will continue to review our financial condition and will provide an updated plan in thirty (30) days with revised projections, as well as detailed information regarding efficiencies and potential revenue streams. At that time, I will meet with you and/or your staff to review our financial plan and provide additional updates.

If you have any questions, please contact me at (323) 881-6180, or your staff may contact Administrative Deputy Chief Dawnna Lawrence at (323) 881-2426.

DLO:dbl

Attachment

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MACIAS
CONSULTING
GROUP

CONSOLIDATED FIRE PROTECTION DISTRICT OF LOS
ANGELES COUNTY
REVIEW OF FINANCIAL VIABILITY AND FISCAL
SUSTAINABILITY

JULY 2012

MACIAS
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MCG Highlights

Why MCG Conducted the Review

The Fire District, as a special district, is funded independently of the County of Los Angeles General Fund and must operate within its available funding. As a result, the Fire District must rely on multi-year fiscal planning to ensure adequate funding is available to sustain all current emergency and support services. To assist the Fire District, Macias Consulting Group (MCG) was asked to conduct the following:

- Validate the accuracy of the fiscal forecast from FY 2011-12 through 2014-15.
- Determine the accuracy of property tax growth projections for the Fire District.
- Provide alternative methodology or assumptions for a more accurate forecast, and the corresponding impact of the alternatives to the forecast.

What MCG Recommends

1. The Fire District should develop a long-term capital project/infrastructure plan (5, 10 or 15 year minimum) using a net present value computation method.
2. The Fire District should develop and implement quality assurance procedures to ensure the accuracy of project estimates. These procedures should be documented and can include validating the computation formulas used for preparing estimates and checking the reasonableness of the methodology used by staff.

Consolidated Fire Protection District of Los Angeles County – Review of Financial Viability and Fiscal Sustainability

What MCG Found

Overall, the Consolidated Fire Protection District of Los Angeles County (Fire District) budget projection process uses reasonable methods, data sources and adjustments for its revenue and expenditure forecasts. The Fire District uses actual historical data that is adjusted appropriately to reflect changing factors and anticipated issues. While we were unable to assess the accuracy of property tax growth projections, we determined the Fire District was reasonable in its current approach for estimating future property tax revenues.

Our analysis of capital cost estimates for 11 anticipated infrastructure projects showed the components and methods used to estimate the costs were reasonable; however, the cost estimates for two of the 11 projects need to be revised. The adjusted cost estimate for the Septic Tank project and the Headquarters Refurbishment project are included in this report. We noted the Fire District can use an alternative process for developing cost estimates by using a long-term capital project/infrastructure plan.

Finally, the cost savings estimates that we reviewed on 11 activities were reasonable and accurate.

Principal Results

Fire District has had Success is Keeping Expenditures Aligned with Revenues

Financial viability evaluations can help determine whether jurisdictions are heading for trouble prior to a financial crisis and serve to inform officials on how well they are doing. Our analysis of five key fiscal health indicators¹ shows the Fire District is successful in keeping costs in line with total revenues.

We examined changes in the Fire District's revenues relative to changes in population size for the Fire District.² As population increases, it might be expected that revenues and the need for services would increase. As shown in Figure 1.0, the Fire District's revenues per capita was \$209.70 in FY 2007-08 and increased slightly to \$216.05 per capita by FY 2010-11. If population growth substantially increases, the Fire District may face some challenges in maintaining existing service levels unless it finds new revenue sources or implements other cost savings initiatives.

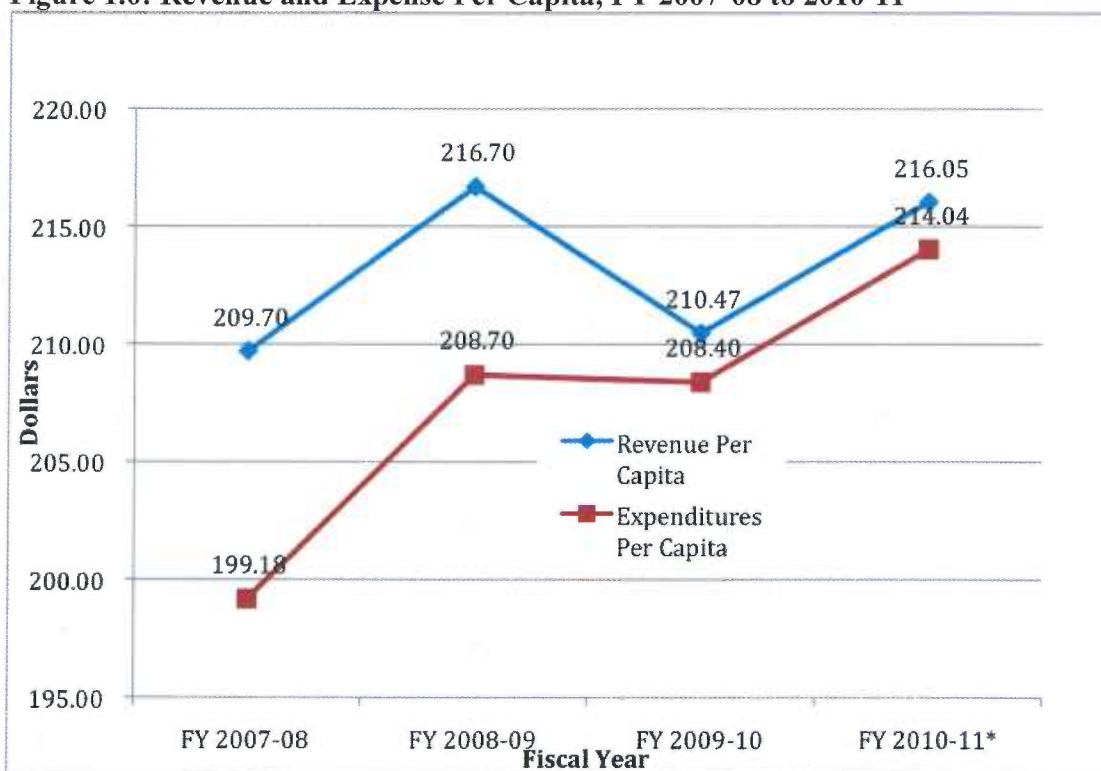
We also examined changes in the Fire District's expenditures relative to changes in population. As the population increases, it is expected that service levels and corresponding expenditures would increase. As shown in Figure 1.0, the Fire District's expenditures per capita was \$199.18 in FY 2007-08 that increased to \$214.04 per capita by FY 2010-11, indicating the cost of providing services increased as the population changed.

Comparison of revenues and expenditures per capita trends suggests the Fire District has done well, to date, to align its operating and other costs with available resources. The Fire District may not be able to sustain its current level of service or pay for large capital projects without finding additional sources of revenue, or implement other cost savings actions.

¹ Total revenues per capita, total expenditures per capita, property tax revenues to total revenues, intergovernmental revenues to total revenues, and salary and benefit expenses to total expenditures.

² Population data used for Fire District was provided by the Planning Division that adjusted data from the State of California, Division of Finance.

Figure 1.0: Revenue and Expense Per Capita, FY 2007-08 to 2010-11

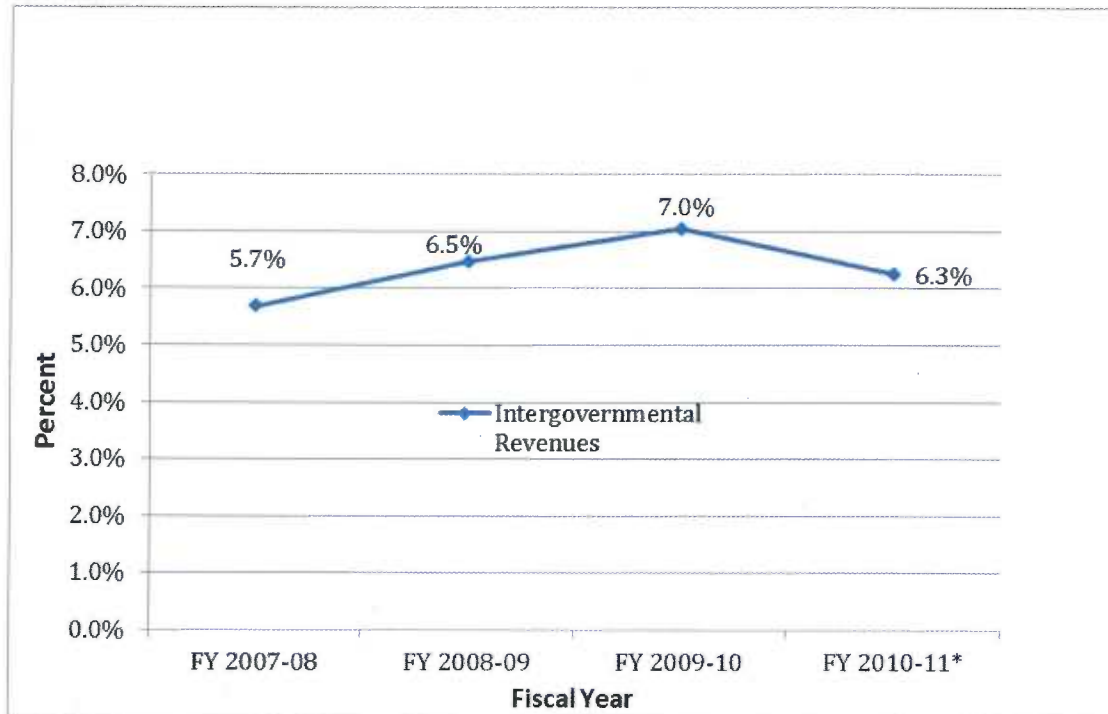


* Based upon unaudited financial data.

Source: MCG generated chart.

Intergovernmental revenues are revenues received from the county, state and federal levels of government. An analysis of this revenue source shows whether there is an over dependence on such revenues. Any over dependence can be harmful should the level of support decline. As shown in Figure 2.0, intergovernmental revenues have served as a stable revenue source for the Fire District, ranging from 5.7 percent to 7.0 percent over the last four years.

Figure 2.0: Intergovernmental Revenue as a Percentage of Total Revenue, FY 2007-08 to 2010-11

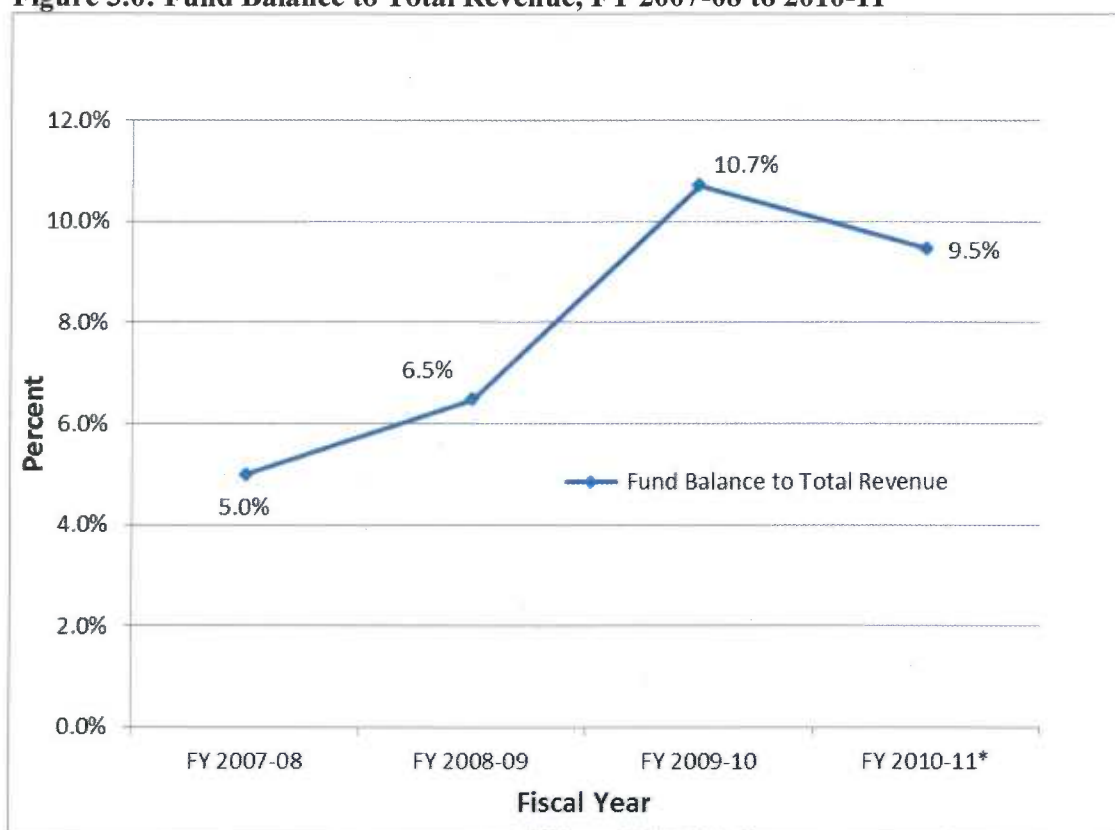


* Based upon unaudited financial data.

Source: MCG generated chart.

Fund balances are not always synonymous with funds available, but their size can affect the Fire District's ability to withstand changing conditions or emergencies. It can also affect the Fire District's ability to accumulate funds for capital purchases without taking on additional debt. As shown in Figure 3.0, the ratio of fund balances to revenues increased from 5.0 percent in FY 2007-08 to 9.5 percent in FY 2010-11, suggesting the Fire District can withstand minor emergencies if its financial sustainability remains at current levels.

Figure 3.0: Fund Balance to Total Revenue, FY 2007-08 to 2010-11



* Based upon unaudited financial data.

Source: MCG generated chart.

Projected Revenues and Expenditures Estimates Are Accurate

Projecting revenues and expenditures for subsequent years is a common practice among public agencies. The results provide a means for long-term financial planning. Our analysis of eight key revenue sources valued at \$869,920,000 for FY 2014-15 and five key expenditure categories valued at \$905,130,000 shows the Fire District uses reasonable methods, data sources and adjustments to develop budget projections. The budget projections are based on actual historical data that are appropriately adjusted to reflect known factors and conditions. It is important to note there is inherent uncertainty in any financial projection.

While the Fire District reasonably projects the amount of property tax revenue that it will receive, we attempted to determine the accuracy of the County Assessor's forecasts of anticipated property tax revenue. This evaluation was important to ensure that the Fire District was accurately projecting revenues from its share of property tax allocations. However, we were not able to coordinate work with the County Assessor's Office within the timeframe of this review. Nonetheless, the County Assessor's Office reported that its current methodology is under review and will likely begin partnering with the County Chief

Executive Office to modify and/or establish new methodologies to jointly develop future forecasts. It is not known whether any subsequent changes would lead to increases or declines to the Fire District's share of property tax revenue.

As shown in Figures 4.0 and 5.0, the Fire District has received lower levels of property tax revenues for FY 2009-10 and FY 2010-11 after 11 years of revenue increases (from year-to-year).

Figure 4.0: Property Tax Revenue Historical Increase and Recent Decline

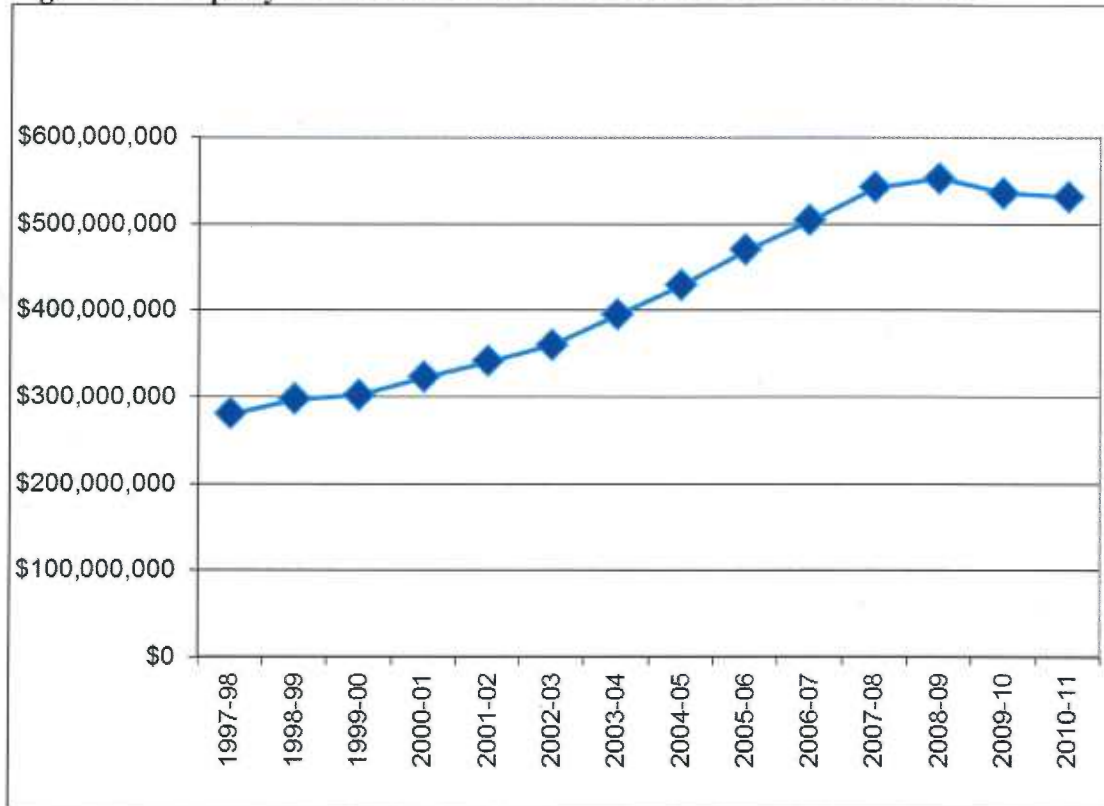
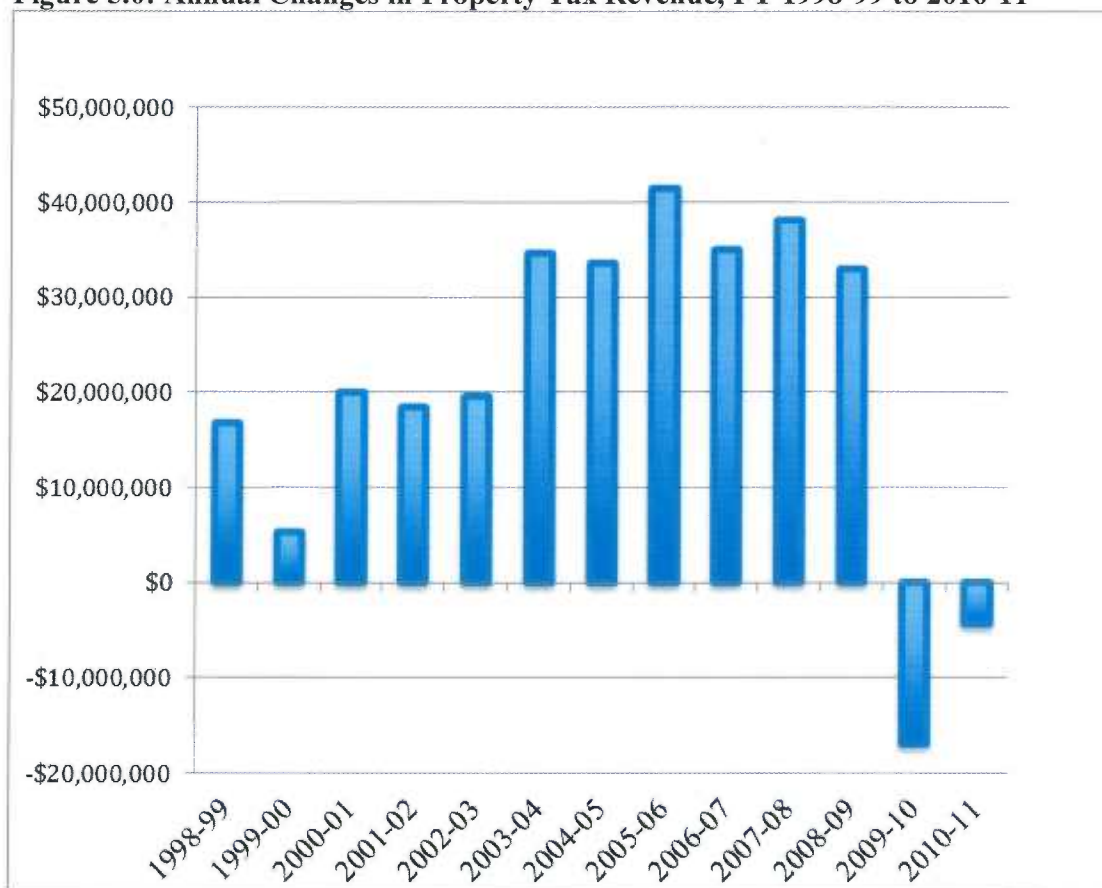


Figure 5.0 below shows the actual dollar value of the downturn in property tax revenue.

Figure 5.0: Annual Changes in Property Tax Revenue, FY 1998-99 to 2010-11



The Fire District's current projection assumes a modest return to growth in property tax revenue based on County Executive Office management judgment of improving economic and housing conditions over time. Specifically, the Fire District's projections account for modest growth ranging from 1.14 percent to 3.20 between FY 2011-12 and FY 2016-17, as shown in Table 6.0 below. We find these to be reasonable growth estimates to factor into the projection.

Table 6.0: Property Tax Growth Projection Estimates

| Fiscal Year | Property Tax Growth |
|-------------|---------------------|
| 2011-12 | 1.70% ³ |
| 2012-13 | 1.14% ⁴ |
| 2013-14 | 2.40% ⁵ |
| 2014-15 | 2.60% |
| 2015-16 | 3.00% |

³ Source of estimate: Auditor-Controller's Office.

⁴ Source of estimate: County Assessor's Office.

⁵ Source of estimate: Chief Executive Office for FYs 2013-2017.

2016-17

3.20%

For other revenue projections, the Fire District appropriately factored potential material events and circumstances. For example, projections for "Other Revenue" weighed the financial impact from the closure of redevelopment agencies. Also, revenue projections from the settlement of Educational Revenue Augmentation Fund (ERAF) factored in declines that occurred in previous years.

Our analysis of expenditure projections found the Fire District appropriately accounted for potential increases to primary employee benefits, such as retirement costs, health care costs, retiree health insurance and workers' compensation. Expenditures for these sub-categories are expected to substantially increase while salary and wage expenditures remain stable. Currently, the salary expenditures assume no cost-of-living-adjustment (COLA). Determining whether COLA should be included in the budget projections is generally an executive management decision.

Cost Estimates for Critical Infrastructure Projects are Reasonable

The Fire District has developed capital cost estimates for 11 anticipated infrastructure projects in their Critical Infrastructure Project Summary, as follows:

| Infrastructure Project | Cost Estimate |
|---|---------------|
| Privacy and Access Compliance | \$70,000,000 |
| Septic Tank Repair/Replacement Projects | \$10,702,000 |
| Potable Water Upgrade Projects | \$8,020,870 |
| Fire Station Replacement | \$90,352,000 |
| New Headquarters Construction | \$164,279,000 |
| Klinger Replacement | \$38,390,400 |
| LA Headquarters Refurbishment and Stabilization | \$21,585,714 |
| Computer Aided Dispatch Replacement | \$8,750,000 |
| Network Infrastructure | \$8,000,000 |

| | |
|--|--|
| Replace Baywatch Rescue Boat Headquarters | Not evaluated. This project is in adopted budget as expenditure. |
| Replace Two Baywatch Rescue Boats | \$1,185,000 |
| Helicopter Replacement | \$62,500,000 |

We assessed the methodology in developing 11 of the 12 project cost estimates and found the sources and methods used to develop costs were reasonable. At the time of our review, the remaining project – replacing the Baywatch Rescue Boat Headquarters – had already been included in the adopted budget as an expenditure item, so we did not validate the accuracy of the estimate. Cost estimates for the 11 projects are generally supported by preliminary cost estimates, some prepared by professional services firms on contract to the Department of Public Works. For projects that could be long term, such as construction related projects, the cost estimates appropriately included a contingency amount.

The cost estimates for 2 of the 11 projects need to be revised. For the Septic Tank project, the cost estimate should be \$10,112,000 instead of \$10,702,000. For the Headquarters refurbishment project, the cost estimate from the 2008 report should be updated to make sure that it is a current and accurate. This is common practice for four-year old estimates. The 2008 cost estimate should be adjusted by 12.5 percent, for a revised cost estimate of \$24,283,928. The cost estimates for the remaining 9 projects are accurate.

We noted the cost estimates for the infrastructure projects should be captured separately in a Fire District specific capital project/infrastructure plan, which the District has already recognized that it needs in its draft strategic plan. Such a plan provides a description over a specific period time, from 5 to 15 years; the need for large capital projects; their nature; and timeframe for completion. A capital project plan also provides information to decision-makers to rank the priority of projects to be completed, as well as the projected costs of the projects using popular methods of capital budgeting, such as net present value (NPV)⁶, internal rate of return (IRR), discounted cash flow (DCF) and payback period.

Developing a capital project/infrastructure plan -- a financial management best practice -- would aid in making better infrastructure projections and better presentations of project information. Presently, the Fire District presents three separate cost estimates related to its headquarters building. One estimate is for constructing a new headquarters building along with other construction at the same site (\$164 million), another cost estimate is for replacing the existing Klinger headquarters building only (\$38 million), and the final cost estimate is for refurbishing and stabilizing the Klinger building (\$22 million). A capital budget process

⁶ Net present value is a method to compare the cost of the project now with the cost in the future and is the standard criterion for deciding whether a government program can be justified on economic principles (benefits minus costs).

would actually include a description that these projects are actually “options” for management consideration to address the headquarters building issue.

Cost Savings Estimates Were Accurate

To help offset costs to build the infrastructure projects, cost savings from other areas can be realized. The Fire District, in a county-wide effort to explore efficiencies as a means to generate on-going or one-time savings, identified 11 cost-efficiency efforts as described by the Fire District’s Efficiency Savings Summary. These include:

- water main construction project;
- tire retread program;
- unused phone line disconnection;
- heart code online advanced cardiac life support program;
- risk exposure cost avoidance plan;
- carve out program;
- cell phone – data reduction;
- fuel efficiency pilot program;
- utilities reduction and conservation;
- vehicle accident reduction; and
- wellness fitness North Region pilot program.

Four of the 11 projects -- water main construction project, tire retread program, unused phone line disconnection program, and the heart code online advanced cardiac life program -- reported cost savings of \$736,000. The documentation provided for these four projects was adequate to support estimated savings.

We further assessed the methods used by the Fire District to estimate the cost savings for the four projects and found most of them to be reasonable. For example, in estimating cost savings for the tire retread program, the Fire District calculated the cost of tires that it would not have to purchase because of extending the life cycle of existing tires, a reasonable method. We did identify the cost savings estimated for the water main construction project of \$100,000 should be lower. While the Fire District was reasonable in its method to compare a contractor’s estimate with the cost of completing the project in-house, we found that the Fire District did not include fully the in-house labor cost for the work. Factoring in such labor expenses would have lowered the amount of saving.

Recommendations

We recommend that the Fire District:

1. Develop a long-term capital project/infrastructure plan (5, 10 or 15 year minimum) using a net present value computation method.
2. Develop and implement quality assurance procedures to ensure the accuracy of project estimates. These procedures should be documented and can include validating the computation formulas used for preparing estimates and checking the reasonableness of the methodology used by staff.

Appendix A: Objectives, Scope and Methodology

The Fire District contracted with MCG to address the following objectives:

- Validate the accuracy of the fiscal forecast from FY 2011-12 through 2014-15.
- Determine the accuracy of property tax growth projections for the Fire District.
- Provide alternative methodology or assumptions for a more accurate forecast, and the corresponding impact of the alternatives to the forecast.

To accomplish these objectives, we, as requested by the Fire District:

- Evaluated revenue and expenditure projections for the following categories: property taxes, special taxes, contract revenue, assistance by hire revenue, federal/state revenue, salaries and employee benefits, services and supplies, other charges, capital assets and other financing uses.
- Evaluated estimated infrastructure costs as identified in the Fire District's Critical Infrastructure Project Summary.
- Evaluated the cost-savings estimates related to efficiencies described in the Fire District's Efficiency Savings Summary.

We interviewed Fire District personnel who were integral in preparing budget projections and in requesting and using cost estimates, particularly with projects included in the Critical Infrastructure Projects Summary. We collected and analyzed documentation related to developing the budget projection, cost estimates and cost-efficiency savings activities. As part of our efforts to ensure the accuracy and reliability of the data, we selectively traced numbers and verified computations. We also interviewed non-Fire District representatives from the County of Los Angeles Chief Executive Office, the Auditor-Controller's Office and the Department of Public Works to obtain their perspective and to verify what they had provided the Fire District. Our request to meet with a representative of the County Assessor's Office to evaluate the accuracy of the property tax revenue allocation projection could not be coordinated within the timeframe of this review.

Our work was performed between May 29, 2012 and June 22, 2012.